

Message Text

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ACTION NEA-06

INFO OCT-01 SS-14 ISO-00 EUR-08 IO-03 EB-03 SP-02 INR-05

L-01 H-01 PRS-01 PM-03 SAB-01 SAM-01 RSC-01 /051 W

----- 059492

P R 210821Z OCT 74

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC PRIORITY 4254

INFO AMEMBASSY BERN

AMEMBASSY BONN

USMISSION GENEVA

AMEMBASSY PARIS

C O N F I D E N T I A L TEL AVIV 5973

LIMDIS

E.O. 71652: GDS

TAGS: EFIN, IS

SUBJ: ISRAELI FINANCIAL SCANDALS

REF: TEL AVIV 5319, 5552, 5783 AND 5886

1. SUMMARY: FULL IMPLICATIONS OF ISRAEL'S CURRENT BANK FAILURES ARE DIFFICULT TO READ AT THIS STAGE. ISRAEL CORPORATION-ROSENBAUM AFFAIR CAME HARD ON HEELS TF ISRAEL-BRITISH BANK FAILURE, BOTH OF WHICH ARE LOOKED ON AS MAJOR SCANDALS. POLITICAL IMPACT IN ISRAEL AND DAMAGE CAUSED TO ISRAEL'S ECONOMY AND TO REPUTATIONS OF CERTAIN PERSONALITIES AMONG COUNTRY'S ECONOMIC LEADERSHIP ARE NOT YET CLEAR. HIGHEST LEVELS OF GOVERNMENT ARE CURRENTLY ENGAGED IN RESCUE OPERATION AIMED AT CUTTING LOSSES AND AVOIDING SLOW DOWN IN INVESTMENT FLOW. END SUMMARY.

2. ISRAEL-BRITISH BANK FAILURE INVOLVES POTENTIAL LOSSES IN EXCESS OF \$100 MILLION TO ISRAELI AND FOREIGN DEPOSITORS, MAINLY FOREIGN BANKS. BANKING AUTHORITIES ARE STILL TRYING TO FIND SATISFACTORY SOLUTION WORKING WITH BANK OF ENGLAND AND PRIVATE BANKING INTERESTS. LATEST EPISODE
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IS MORE FAR-REACHING, INVOLVING GOVERNMENT'S CHOSEN

INVESTMENT/DEVELOPMENT INSTRUMENT--ISRAEL CORPORATION--
AS WELL AS LABOR PARTY LEADERSHIP (AT LEAST THOSE WITH
ECONOMIC RESPONSIBILITIES SUCH AS FORMER FINANCE MINISTER
SAPIR) AND MAJOR FINANCIAL SUPPORTERS OF ISRAEL THROUGHOUT
WORLD. PRIME MINISTER RABIN AND FINANCE MINISTER RABINOWITZ
ARE PERSONALLY DIRECTING THE RESCUE OPERATION.

3. REASONS FOR GOVERNMENT INTERVENTION FOLLOW: (A) TO
PROTECT IC AND ITS BIG FOREIGN CONTRIBUTORS. IC WAS ESTA-
BLISHED IN 1968 FOR EXPRESS PURPOSE OF MARSHALLING FUNDS
FROM WEALTHY JEWS AROUND WORLD FOR INVESTMENT IN ISRAEL.
MEMBERS OF BOARD OF IC AND MAJOR CONTRIBUTORS
CONSTITUTE ALMOST A "WHO'S WHO" OF WORLD JEWRY; (B) TO
PROTECT DEPOSITORS IN INTERNATIONAL CREDIT BANK IN GENEVA
AND ROSENBAUM'S LIECHTENSTEIN OPERATIONS. TOTAL AMOUNT
INVOLVED IS ESTIMATED TO BE AS MUCH AS \$200 MILLION HELD
BY SEVERAL THOUSAND DEPOSITORS. SOME OF THESE DEPOSITS,
INCLUDING CAPITAL RAISED IN SOUTH AFRICA FOR INVESTMENT IN
IC SHARES, WERE TEMPORARILY DEPOSITED IN GENEVA AND LIECHTEN-
STEIN AWAITING EITHER ISSUANCE OF IC SHARES OR ANTICIPATED
DEVALUATION OF ISRAEL POUND BEFORE INVESTMENT IN ISRAEL;
(C) TO PROTECT ISRAELI FINANCIAL REPUTATION AND FOREIGN
INVESTMENT IN ISRAEL; (D) TO AVOID EMBARRASSMENT TO GERMAN
MINORITY PARTNER IN GENEVA-BASED INTERNATIONAL CREDIT BANK.
ACCORDING TO OFFICIALS HERE, GERMAN PARTICIPATION, THROUGH
HESSISCHE LANDESBANK, INVOLVES GERMAN SOCIAL DEMOCRATS WHO
IRE GOOD FRIENDS OF ISRAEL.

4. ATTITUDE OF BARON EDMOND DE ROTHSCHILD, IC CHAIRMAN,
IS IMPORTANT ELEMENT IN EFFORT TO FIND A SOLUTION. HE
CALLED MEETING OF IC EXECUTIVE COMMITTEE IN PARIS
OCTOBER 18 TO DISCUSS VARIOUS POSSIBLE ACTIONS. UNTIL NOW
ROTHSCHILD HAS OPPOSED IC'S JOINING FORCES WITH CONSORTIUM

OF CREDITORS, BUT OBSERVERS BELIEVE HE MAY HAVE CHANGED HIS
MIND AFTER INTERVENTION BY PRIME MINISTER RABIN. FIFTEEN-MAN
LOAD MET BUT DID NOT ANNOUNCE ANY PLAN FOR SETTLEMENT. PRESUMABLY,
ANY SOLUTION WILL HAVE TO AWAIT FURTHER TALKS WITH ISRAEL'S MAJOR
BANKS AND WITH GERMAN BANKING INTERESTS.

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5. THESE DEVELOPMENTS HAVE HAD A TRAUMATIC IMPACT IN ISRAEL
AND AMONG LEADING SUPPORTERS OF ISRAEL ELSEWHERE. AS
WOULD BE EXPECTED, HOWEVER, OPINION IS DIVIDED. SUPPORTERS
OF GOVERNMENT, WHILE CALLING FOR FULL INVESTIGATION AND
REFORM WHERE NECESSARY, TEND TO TAKE RELATIVELY RELAXED
VIEW. THEY MAINTAIN THAT EXISTING ECONOMIC SYSTEM, WHICH
FOR SO MANY YEARS WAS RUN PRETTY MUCH FROM SAPIR'S HIP
POCKET WITH VERY LITTLE INDEPENDENT AUDIT OF CONTROL, HAS

SERVED ISRAEL WELL. CURRENT PROBLEMS ARE LARGELY RESULT OF WORLD LIQUIDITY CRISIS, ALTHOUGH THEY CONCEDE THAT ROSENBAUM SHOULD HAVE BEEN MORE CAUTIOUS IN HIS REAL ESTATE AND OTHER SPECULATIVE DEALS. IN GOOD TIMES THEY ADD, BANKS AND PERSONS INVOLVED WOULD HAVE CONTINUED TO MAKE MONEY AND RECEIVE APPLAUSE FOR THEIR SHREWD INVESTMENTS. CRITICS, ON OTHER HAND, MAINTAIN THAT FREE-WHEELING SYSTEM WAS BOUND TO COLLAPSE SOONER OR LATER. IN THIS INSTANCE, THERE WAS INSUFFICIENT CONTROL TO PREVENT BAD FROM GOING TO WORSE, AS CREDIT DRIED UP AND ROSENBAUM AND FRIENDS FRANTICALLY TRIED TO MAKE UP LOSSES ANY WAY THEY COULD. THEY INSIST ON SACKING OF PRESENT MANAGEMENT AND GOVERNMENT REPRESENTATIVES ON BOARDS OF DIRECTORS OF INSTITUTIONS INVOLVED, CRIMINAL PROSECUTION WHERE WARRANTED, AND MUCH TIGHTER MANAGEMENT AND CONTROL OF ISRAEL'S PUBLIC INSTITUTIONS.

6. POLITICAL IMPACT OF SCANDALS WILL DEPEND IN LARGE PART ON HOW QUICKLY AND SUCCESSFULLY GOVERNMENT IS ABLE TO CONCLUDE ITS RESCUE OPERATION. SHEER MAGNITUDE OF SUMS INVOLVED AND NUMBER OF IMPORTANT ISRAELI INSTITUTIONS AFFECTED HAVE GUARANTEED INTENSE PUBLIC INTEREST AND HAVE ALREADY COST GOVERNMENT A CONSIDERABLE EXPENDITURE OF TIME, ENERGY AND POLITICAL CAPITAL. HOWEVER, THERE MAY IN FACT NOT BE MUCH DAMAGE TO REPUTATIONS OF MAJOR POLITICAL FIGURES. EVEN SAPIR, WHO IS NOW HEAD OF JEWISH AGENCY, HAS NOT BEEN ACCUSED OF PERSONAL GAIN OR WRONGDOING, ONLY THAT THE SYSTEM HE CREATED PERMITTED THESE THINGS TO HAPPEN. NEVERTHELESS, WE JUDGE THAT BANK FAILURES ARE LIKELY TO BE A POLITICAL ISSUE FOR SOME TIME TO COME. LABOR PARTY ESTABLISHMENT RUNS ECONOMY AND TWO MAIN VILLAINS--TZOUR AND ROSENBAUM-- WERE CLOSE TO SAPIR AS WELL AS NATIONAL RELIGIOUS PARTY. WHILE MANY OBSERVERS FEAR ADVERSE IMPACT ON FOREIGN INVESTMENT IN ISRAEL, CONFIDENTIAL

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WE INCLINE TOWARD BELIEF THAT EVENTS WILL HAVE ONLY LIMITED ADVERSE IMPACT ON INVESTMENT. FOREIGN FRIENDS OF ISRAEL WHO CONTRIBUTE MAJOR PORTION OF INVESTMENT FLOW, HAVE ALWAYS HAD STRONG MOTIVATION GOING BEYOND THE PURELY ECONOMIC AND, WHILE ANGRY NOW, ARE UNLIKELY TO BE TURNED OFF EASILY. IN ANY EVENT, GOI IS KEENLY AWARE OF ISRAEL'S DEPENDENCE ON GOOD WILL AND FINANCIAL SUPPORT OF WORLD JEWISH COMMUNITY AND WILL MAKE EVERY EFFORT TO TO LIMIT DAMAGE CAUSED BY THESE SCANDALS. KEATING

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: BLOCKED ASSETS, CORRUPTION, BANKS, BANKRUPTCIES
Control Number: n/a
Copy: SINGLE
Draft Date: 21 OCT 1974
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: shawdg
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974TELAV05973
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D740299-0243
From: TEL AVIV
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19741029/aaaaayjr.tel
Line Count: 163
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION NEA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: LIMDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: LIMDIS
Reference: TEL AVIV 5319, 5552, 5783 AND 5886
Review Action: RELEASED, APPROVED
Review Authority: shawdg
Review Comment: n/a
Review Content Flags:
Review Date: 30 APR 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <30 APR 2002 by boyleja>; APPROVED <06 MAR 2003 by shawdg>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ISRAELI FINANCIAL SCANDALS
TAGS: EFIN, IS, (ROSENBAUM, TIBOR)
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005